



Arizona State Senate *Issue Brief*

October 13, 2006

Note to Reader:

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UNEMPLOYMENT INSURANCE

INTRODUCTION

Arizona's Unemployment Insurance (UI) program is administered by the Employment Administration (EA) in the Department of Economic Security (DES) and provides a measure of economic security to the individual worker and the community when unemployment occurs beyond the worker's control. When an employee is eligible for benefits, the state pays those benefits out of the Unemployment Insurance Trust Fund (Trust Fund). Funding for the Trust Fund comes from Arizona's unemployment tax paid by employers; workers in Arizona do not make any payments into the Trust Fund. Employers also pay the federal unemployment tax, known as FUTA, which is collected by the federal government and is used to administer the program at the federal and state levels.

HISTORY AND OVERVIEW

The amount an employer must pay for the Arizona unemployment tax is partially dependent on an employer's "experience rating." Companies with stable workforces that have had few layoffs have better experience ratings and therefore pay less into the Trust Fund. Firms with a history of laying off employees in the last few years have poorer experience ratings and pay more into the Trust Fund. Certain nonprofit organizations, state and local governments and Indian tribes can elect to make payments in lieu of paying taxes. Such payments are a reimbursement to the Trust Fund equal to the employer's proportionate share of benefits paid to its former employees.

An unemployed worker's monetary eligibility for UI benefits is based upon the unemployed worker's insured wages paid during a one-year period, known as the base period. The base period is, in most instances, the first four of the last five completed calendar quarters prior to the date when the applicant first applied for UI. An unemployed worker's eligibility is also based upon the individual's nonmonetary eligibility, which includes the reason for separation from the last employer as well as whether the individual is able to work and is seeking full-time work. The maximum weekly UI benefit varies from state to state; in Arizona it is \$240.

State Unemployment Tax

Arizona unemployment tax is paid on the first \$7,000 in wages paid to each employee in a calendar year. The unemployment tax is used solely for UI benefits. The actual taxes are calculated by multiplying the quarterly taxable wages by the tax rate. New employers are assigned a tax rate of two percent for a minimum of two calendar years. After that, employers may be eligible for a higher or lower tax rate depending on:

- the amount of taxes paid.
- the amount of unemployment benefits paid to former employees and charged to the employer.
- the average size of the annual taxable payroll.
- the overall solvency of the Trust Fund.

These four factors are used to compute the tax rate using a “reserve ratio” system – basically a cost-accounting system. The taxes paid minus the amount of benefits attributable to the business are divided by the firm’s average annual taxable payroll to produce a reserve ratio. Therefore, the higher the reserve ratio, the lower the tax rates.

FUTA

Most employers who pay Arizona state unemployment tax are required to pay the FUTA tax. The annual FUTA tax is used to fund the administrative costs of the UI program, while the Arizona state unemployment tax is used solely for the payment of benefits to unemployed workers.

The FUTA tax of 6.2 percent is also assessed on the first \$7,000 in wages paid to each worker in a calendar year. When state taxes are paid on time, a tax credit of 5.4 percent is awarded to reduce the FUTA tax, regardless of the Arizona unemployment tax rate. The credit is equal to the actual tax rate, plus the difference between that percentage and 5.4 percent. This means that Arizona employers who pay their state taxes timely pay a net federal tax of 0.8 percent. If an employer does not pay its

state taxes on time, the employer will only receive 90 percent of the allowable credit.

Job Training Tax

Effective January 1, 2001, a 0.10 percent job training tax is imposed on taxable wages. The job training tax is not part of an employer’s experience rating or included in the unemployment tax rate. Employers began paying the job training tax with their unemployment taxes at the end of the first quarter of 2001. Certain employer groups are exempt from the liability to pay the job training tax, including employers who chose the reimbursement option or those assigned a tax rate of 2.00 percent or 2.70 percent. The job training tax funds the Arizona Job Training Program administered by the Arizona Department of Commerce. The Arizona Job Training Program supports the design and delivery of training plans that meet unique industry standards and challenges. The mission of the Arizona Job Training Program is to promote economic prosperity by providing qualified businesses with the resources to train and develop Arizona’s workforce. (A.R.S. §§ 23-769 and 41-1541, et al.)

SUTA Dumping

When a person acquires all or part of a business, the person becomes the “successor” for unemployment tax purposes. As the successor, the person is immediately liable for unemployment taxes regardless of the amount of wages the successor pays or the number of employees. If a successor acquires an entire business and continues its operations, the successor is assigned the tax rate and experience rating account of the former owner. The experience rating includes the record of wages and taxes previously paid. Therefore, any unemployment benefits awarded are based on wages paid by the former owner and may be charged to the new employer’s account.

Federal and state UI agencies found that companies were able to manipulate state experience rating systems so that the employers paid lower state unemployment compensation

taxes than their unemployment experience rates would otherwise have allowed. Companies took two different approaches. Some formed a new corporation, transferred their employees to that company and used the new company's lower experience rating to reduce the original firm's unemployment tax liability. Others bought a different firm with a lower unemployment tax liability and used the purchased business' rate to gain a lower experience rating.

This practice became known as SUTA dumping (SUTA refers to state unemployment tax acts). In 2004, the federal SUTA Dumping Prevention Act of 2004 (SUTA Act) was adopted. The SUTA Act required state unemployment compensation laws, as a condition of participating in the federal-state UI program, to provide for the transfer of unemployment experience ratings upon the transfer or acquisition of a business. In 2005, the Legislature adopted a measure in response to the SUTA Act, requiring experience ratings to be transferred upon the transfer or acquisition of a business, specifying requirements for DES when determining if the successor acquired the business to obtain a lower contribution rate and providing penalties for violating the experience rating requirements.

ADDITIONAL RESOURCES

- Arizona Department of Economic Security
Employment Administration
www.de.state.az.us/esa/default.asp
- Online Unemployment Insurance Services
www.azui.com
- DES UI Benefit Call Centers
Maricopa County: 602-364-2722
Pima County: 520-791-2722
All others: 1-877-600-2722
- Unemployment Insurance Statutes: Arizona
Revised Statutes, Title 23, Chapter 4
- Arizona Job Training Program
Arizona Department of Commerce
www.azcommerce.com